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DEPT FOR AF A A/S CARTER, AF/SPG, AF/E
DEPT PLS PASS USAID FOR AFR/SUDAN
DEPT PLS PASS TREASURY FOR OIA, UESD IMF, USED WORLD BANK
ADDIS ABABA FOR USAU

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SUBJECT: GNU STATE MINISTER OF FINANCE BLAMES HIS SPLM COMRADES FOR
FOREIGN EXCHANGE DISPUTE

REF: A) 08 KHARTOUM 1456
B) 08 KHARTOUM 1578

11. (SBU) SUMMARY: SPLM-appointed State Minister of Finance in the Government of National Unity (GNU) Lual Deng laid the blame for the festering dispute over the control of foreign exchange reserves squarely on the Government of Southern Sudan (GoSS), by having turned a technical issue into a high-level political dispute. Deng said that the CPA clearly makes monetary policy, and hence the control of foreign-currency reserves, the responsibility of the central bank, and that the GoSS had reneged on an earlier agreement that all had thought resolved the issue. He urged that the U.S. tell the GoSS that it is in the wrong and to reach an agreement with the GNU. END SUMMARY.

12. (SBU) On February 1, CDA Fernandez and econoff called on Dr. Lual Deng, the SPLM-appointed State Minister of Finance in the GNU, to discuss the continuing dispute between the GNU and the GoSS over control of foreign exchange (FX) reserves (reftels). Charge Fernandez said that he was seeking meetings with other GNU officials, including Finance Minister Al-Jaz and Central Bank of Sudan (CBOS) Governor Sabir Hassan, to express USG concern and seek their advice on how to assist in resolving the dispute. The Charge said that the USG is aware that the two sides are discussing the issue, but is concerned that the longer it drags on without resolution, the greater the danger that it will emerge as a full-blown political crisis. The U.S. does not want to make the situation worse by going public yet, but is deeply concerned that the GoSS is heading towards a financial crisis, at which point the USG will have no choice but to take a public stand and apportion blame. Whoever is at fault, blame would certainly fall on the GNU and the National Congress Party (NCP). The U.S. and others in the international community want to help resolve the issue before it reaches this point, he said.

13. (SBU) State Minister Deng replied that it is first necessary to clear up "confusion" about the issue. He said emphatically that under the CPA (Art. 14.2), the CBOS is responsible for making and implementing monetary policy for the entire country, and the Bank of Southern Sudan (BoSS) is a branch of the CBOS. This system was agreed to at Naivasha with the advice of the IMF. FX-reserve management is a key instrument of that monetary policy. The reserves held by the BoSS do not belong to the GoSS. Rather they are there to provide the people of the south the FX needed to carryout commercial transactions requiring foreign currency. Any FX generated by the southern economy can remain there as needed and the CBOS will provide any additional reserves needed to meet local demand. (Note: The GoSS has contended that the CBOS has not been responsive to requests for additional FX, one of its arguments for holding on to reserves. End Note.) "Things were going alright until the (GoSS) Minister of Finance claimed the money" as the GoSS's, Deng said.

¶4. (SBU) Deng commented that the problem is now becoming acute due to the precipitous decline in oil revenues on which the GoSS is totally dependent, although they are in fact two different issues. GoSS revenues in the first quarter of 2009 will be only equal to what it collected in November 2008, he noted, and it is rapidly drawing down its reserves. He lamented the habit of both the NCP and the SPLM to blame each other for their difficulties. He warned that were the U.S. to blame the NCP and GNU for the problem, it only will convince the GoSS that it has U.S. support to do whatever it pleases.

¶5. (SBU) Deng continued that the GoSS has not been well advised, including by the U.S. Rather than contravening the CPA and blaming the GNU for its difficulties, the GoSS would do better to focus on identifying other, reliable revenue sources. U.S. should tell the GoSS to cool down and not blame the GoS or the NCP for its financial difficulties. The IMF could properly advise the GoSS on putting its fiscal house in order. Deng recalled that the international community, including the USG, was deeply mistaken when it "did nothing and said nothing" when the SPLM/GoSS lost one billion dollars in 2006 which could be serving now as a reserve fund.

¶6. (SBU) CDA Fernandez repeated that the U.S. wants to see the current dispute resolved quietly at the technical level, before it reaches the crisis point, and becomes an opportunity for mutual demagoguery. He agreed that neither the NCP nor the SPLM lives up to agreements they make and both are quick to blame the other. He said that the U.S. has told the GoSS that it should resolve this issue as soon as possible, and has avoided commenting on the matter publicly so far. "We respect the experts," he said, "but the rules will change if it becomes a political issue." Deng remarked that he has

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"told them (the SPLM) they are wrong," but he added "you are more powerful than me in the south."

¶7. (SBU) CDA informed AEC Chairman Plumbly of the discussion and Plumbly subsequently met with Deng and CBOS head Sabir Hassan on February 2. Hassan continues to be difficult, feeling that he is right on the letter of the agreement and that the NCP has the SPLM over a (literally and figuratively) barrel. Embassy will continue to stress to GNU and NCP officials that an "implosion in governance" in South Sudan because of economic issues would be dangerous for both parties to the CPA.

¶8. (SBU) Comment: As both a U.S.-trained, Phd. economist and an SPLM member of the GNU, Lual Deng is as close as we have come to an unbiased source on this dispute. His views align closely with those of CBOS Governor Hassan. As GoSS financial reserves quickly dwindle, it may be more desperate and be more reluctant than ever to compromise. But it also is being pushed into a financial corner from which it may only be able to get out by cutting a deal on the NCP's own terms or expecting an unrealistic financial bailout from its friends in the West at the 11th hour. The precipitous fall in oil revenues plus the hard currency disagreement - which are indeed two separate issues - are placing unprecedented financial pressure on South Sudan's fragile government and could eventually threaten the South's tentative, hard-earned and unprecedented political progress.

FERNANDEZ